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FISCAL ADJUSTMENT, STABILITY AND GROWTH

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In the period prior to the implementation of the *Real* Plan, marked by high inflation rates, the applied economic literature indicated that seigniorage revenues were essential to maintain the sustainability of the Brazilian public debt. For a brief period, after the implementation of the *Real* Plan and ensuing decline of the inflation rates, the revenues from privatisations compensated the revenues from the high inflation rates.

After the substantial reduction of the privatisation proceeds, and within a context of international crisis, at the beginning of the floating exchange regime that increased the Brazilian public debt by approximately 18 percentile points of GDP, the Brazilian government forcibly initiated its fiscal adjustment, which culminated with the primary surplus target of 4.25% of GDP.

Despite the implementation of this fiscal adjustment, alongside the expansion of the federal government's current expenses (table 1), the debate among economists specialised in public finances has intensified, since there is a concern that this expansion might undermine economic growth.

To what extent is this expansion harmful to economic growth? Even if the answer to this question is not as simple as these specialists claim, there are insights to be obtained. For example: there is empirical evidence that links decreased income inequality to increased economic growth rate.¹ Furthermore, in Brazil, applied literature indicates that the intensification of redistributive policies – other social assistance expenditures, Organic Law of Social Assistance (LOAS) and Lifelong Monthly Income (RMV) – reduces income inequality. Thus, if these redistributive policies actually help reduce income inequality, one can also believe that they have a positive indirect effect on economic growth.

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1. See, for example, the evidence found in Alesina and Rodrik (1994) and in Persson e Tabellini (1994).

In this sense, in the last ten years, the fact that the sum of other social assistance expenditures, the LOAS and the RMV, has risen substantially, i.e. from 0.44 percentile point (p.p) of GDP in 1995, to 0.78 p.p. of GDP in 2005, does not mean damage to economic growth (table 1).

In fact, in the Brazilian conjuncture discussion, the growth of current expenses must be better characterized, inasmuch as it is not the growth of any heading of current expenses that is harmful to economic growth. However, according to table 1, the expenditures with social security benefits and transfers to states and municipalities account for most of the variation of current expenses in the last ten years. Moreover, still according to table 1, it is observed that, in the last three years of the Lula Administration, from 2003 to 2005, the average of expenditures with economic subsidies and subventions, about 0.51 p.p. of GDP, is substantially higher than the average of the last term of the Fernando Henrique Administration, from 1999 to 2002, approximately 0.31 p.p. of GDP.

TABLE 1
Composition of public expenditure of the Federal Government (1995-2005)
 (% of GDP)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Personnel and Social Burdens	5.86	5.25	5.11	5.24	5.30	5.29	5.46	5.57	5.07	4.85	4.95
Social Security Benefits	4.84	5.14	5.07	5.69	5.84	5.87	6.23	6.39	6.84	6.67	7.50
LOAS and RMV	0.25	0.24	0.27	0.29	0.29	0.32	0.36	0.39	0.42	0.41	0.49
Other Social Assistance Expenditures	0.19	0.11	0.13	0.15	0.15	0.13	0.17	0.24	0.32	0.40	0.29
Unemployment Insurance and Salary Allowance	0.52	0.51	0.47	0.52	0.48	0.43	0.48	0.53	0.54	0.51	0.60
Health Costing	1.45	1.26	1.43	1.33	1.51	1.48	1.54	1.54	1.45	1.44	1.64
Transfers to States and Municipalities	2.94	2.83	2.88	3.22	3.31	3.61	3.84	4.16	3.97	3.69	4.72
Economic Subsidies and Subventions	0.16	0.03	0.13	0.28	0.44	0.26	0.36	0.20	0.39	0.52	0.62
Other Current Expenses	1.91	1.78	1.90	1.96	1.92	2.05	2.02	2.26	1.83	1.84	2.37
Sum of Current Expenses	18.1	17.2	17.4	18.7	19.2	19.4	20.5	21.3	20.8	20.3	23.2
Investments	0.73	0.73	0.87	0.91	0.71	0.92	1.22	0.75	0.41	0.59	0.91
Financial Investments	0.22	0.96	0.19	0.35	0.07	0.30	0.45	0.10	0.11	0.17	0.17

Source: Ipea/Dirur/CFP.

The economic expenditures with subsidies and subventions are basically discretionary, so it is possible to reduce the rate of concessions, which has been rising in the last three years. These expenditures do not contribute to the reduction of income inequality, and most of them result from political agreements to refinance public financing of the agricultural sector.

As regards the growth of expenditures with transfers to states and municipalities, we do not envisage a reduction in the short term, since these expenditures result from negotiations around the federative pact between the Federal Government, the states and the municipalities. Therefore, even if these

expenditures do not promote economic stability and growth, they might promote democratic stability. In addition to these issues, there are others concerning the Brazilian fiscal federalism that are beyond the scope of this article.

Despite their impact on inequality reduction and the fact that their concession is compulsory, there is a drawback concerning the welfare benefits of the General Regime of Social Security (RGPS). At some point, the substantial growth of expenditures with welfare benefits will require from Brazilian society, by means of the National Congress, the following discussion: is the current social security regime a right or a privilege? When analysing the quality of the current fiscal adjustment and its contribution to economic stability and growth, it is impossible not to focus on the growth of spending on welfare benefits, from approximately 4.84 p.p. of GDP in 1995, to about 7.50 p.p. of GDP in 2005.

The National Congress needs to decide on the situation of the RGPS. If it decides that the current RGPS benefit is a right, it needs to establish changes in health costing and in redistributive expenditures. If it decides that it is a privilege, the concession of RGPS benefits will need urgent reform. Whichever its decision, one thing is clear: the problem of the Brazilian fiscal adjustment is not in the expansion of all the current expenses, but rather, specifically, in the substantial rise of expenditures with welfare benefits, as observed in table 1. Moreover, in this environment of fiscal adjustment, another obstacle to economic growth seems to be the low average of public investment. However, we believe that this obstacle can be addressed through the implementation of government current account saving as a fiscal target, as outlined in the next article.